

CAPSTONE BANK

January 19, 2012

Dear Shareholder:

The year 2011 was one in which CapStone Bank achieved good balance sheet results but experienced less than expected net income performance. For the year ended December 31, 2011, total assets grew from \$197 million to \$216 million, an increase of \$19 million or 9.8%. Loans outstanding for the same period were \$147 million compared to \$136 million for the preceding year, an increase of \$11 million or 8.1%. For the same comparative period, total deposits grew from \$126 million to \$151 million, an increase of \$25 million or 20.1%. Total equity grew from \$26 million to \$28 million, an increase of \$2 million or 5.9% on a year over year basis. We are very pleased with this growth, especially during the difficult economic environment of 2011.

Net income for the year ended December 31, 2011 was \$676,000 compared to \$1.2 million for the previous year, a decrease of \$557,000. The results for 2011 were negatively impacted by a one-time, non-recurring personnel expense of \$407,000 and an increase of \$1 million in the provision for loan losses. Our pre-tax, pre-provision income for the year ended December 31, 2011 was \$3.3 million compared to \$3.1 million for the prior year, including the one-time, non-recurring personnel expense.

For the quarter ended December 31, 2011, the Bank experienced a net loss of \$424,000 compared to net income of \$105,000 for the same period in 2010, a decrease of \$529,000. This decrease in quarterly earnings was the result of an increase in our provision for loan losses from \$571,000 in 2010 to \$2 million during 2011, an increase of \$1.4 million. This additional provision was made as a result of an increase in our nonaccrual loans and OREO, which grew from \$1.1 million on September 30, 2010 to \$5.8 million at year end 2011. This amount equates to 2.67% of our total assets at year end 2011 compared to 0.99% at year end 2010. After incurring charge offs during the fourth quarter of \$1.2 million compared to \$1.1 million during the same period in 2010, our allowance for loan losses at year end 2011 was \$4.2 million, compared to \$3.0 million a year ago. The Bank's allowance for loan losses to total loans at year end 2011 was 2.84% compared to 2.22% at the end of 2010.

We are disappointed with the deterioration experienced in our asset quality during 2011. However, even with the addition of these nonperforming loans, our asset quality ratios are significantly better than our peer community banks in North Carolina. Our total capital to assets ratio of 13% also continues to be very strong and is significantly above the well-capitalized ratio of 5% required by the regulators.

On a more positive note, I am pleased to announce the addition of Craig George to our executive management team. He joined us in December 2011 as Executive Vice President and Chief Credit Officer, coming to us from Sun Trust Bank (formerly CCB) after a thirty year career in credit administration. I am confident that with the experience of the executive management team, we will be well-poised to deal with the challenging issues resulting from the weak economy and the community banking environment.

There is no doubt that from a net income perspective, the results of 2011 were not as we had hoped. However, we have made some key strategic moves which will enable us to move forward in a positive manner in 2012. In addition to our executive management team, we have a talented team of bankers who are committed to providing an outstanding customer experience for all of our clients. Beginning in 2012, we will begin the implementation of a new strategic direction. It will shift us away from a one-office business bank model to more of a true multi-branch community bank with a more diversified customer base. We plan to open our first full service branch in Cary by the third quarter of 2012. Having operated a loan production office for the past eighteen months, we feel we have established a base of business which will support the new office. We are also considering expanding our product offerings for appeal to a wider base of clients. As we move forward with our plan, we will be mindful we have built our bank on providing superior customer experiences and will maintain that as a priority within our organization.

As we look to 2012, we continue to be concerned about the economic and regulatory headwinds we face. Although the economy does seem to show some small signs of improvement, we believe we will not see a return to strong economic activity and lower unemployment during 2012. The regulatory environment will continue to be stringent and make it difficult for us to work with our customers who are experiencing financial difficulty, as well as making it more difficult to grow our loan base. In spite of this, we believe CapStone will continue to perform at a higher level than our peers, from both balance sheet growth and net income perspectives.

We sincerely appreciate the support of our shareholders during our first five years, and I encourage you to contact me personally at (919) 256-6802 or mpatterson@capstonebank.com with any questions you may have. We also encourage your attendance at our Annual Shareholder's Meeting which will be held at North Ridge Country Club in Raleigh at 10:30 a.m. on Wednesday, May 16, 2012.

Sincerely,



Michael S. Patterson
Chairman, President and CEO

CAPSTONE BANK

Balance Sheet

(Unaudited)

	Actual Dec 2011	Actual Dec 2010	\$ Change	% Change
Assets				
Cash and due from banks	2,293,449	1,389,812	903,637	65
Fed funds sold & repos	204,073	202,708	1,365	0.7
Interest bearing deposits with banks	18,154,218	26,511,848	-8,357,629	-31.5
Investment Securities - Taxable	32,266,062	19,770,655	12,495,407	63.2
Investment Securities - Tax-exempt	13,502,268	8,473,790	5,028,478	59.3
Loans, net of unearned income	147,313,970	136,226,840	11,087,130	8.1
Less: Allowance for loan losses	-4,183,406	-3,023,451	-1,159,955	-38.4
Premises and equipment, net	206,196	302,997	-96,801	-31.9
Accrued interest receivable	716,356	683,834	32,522	4.8
Other assets	6,095,259	6,707,067	-611,808	-9.1
Total Assets	216,568,445	197,246,099	19,322,346	9.8
Liabilities				
Non-Interest Bearing Deposits	20,240,943	12,346,218	7,894,725	63.9
Interest bearing demand deposits	25,657,869	18,822,891	6,834,979	36.3
Savings and Money Market Deposits	49,224,941	38,261,963	10,962,977	28.7
Time Deposits - Retail	25,967,124	30,008,864	-4,041,740	-13.5
Time Deposits - Wholesale	30,371,636	26,713,024	3,658,611	13.7
Total Deposits	151,462,513	126,152,960	25,309,553	20.1
Accrued expenses and other liabilities	1,872,425	828,641	1,043,784	126
FHLB Advances	31,750,000	39,000,000	-7,250,000	-18.6
Other Borrowings	3,448,741	4,792,217	-1,343,477	-28
Total Liabilities	188,533,679	170,773,818	17,759,861	10.4
Equity				
Common stock	12,974,365	10,812,000	2,162,365	20
Capital surplus	11,622,823	13,686,959	-2,064,136	-15.1
Retained earnings	1,534,382	301,305	1,233,077	409.2
Accumulated other comprehensive income (loss)	1,227,220	438,940	788,280	179.6
Net Income	675,975	1,233,077	-557,102	-45.2
Total Equity	28,034,766	26,472,281	1,562,485	5.9
Total Liabilities & Equity	216,568,445	197,246,099	19,322,346	9.8

CAPSTONE BANK

Income Statement

(Unaudited)

	YTD Actual Dec 2011	YTD Actual Dec 2010	\$ Change	% Change
Interest Income				
Interest on Loans	7,553,157	7,538,286	14,871	0.2
Fees on Loans	218,081	179,388	38,693	21.6
Interest on federal funds sold	7,597	4,548	3,049	67
Interest on deposits with banks	411,802	459,993	-48,191	-10.5
Investment Securities - Taxable	967,095	938,283	28,812	3.1
Investment Securities - Tax-exempt	419,238	253,365	165,872	65.5
Total Interest Income	9,576,970	9,373,864	203,106	2.2
Interest Expense				
Interest bearing demand deposits	142,954	193,577	-50,623	-26.2
Savings and Money Market Deposits	284,592	425,411	-140,820	-33.1
Time Deposits - Retail	382,639	597,284	-214,645	-35.9
Time Deposits - Wholesale	211,343	313,130	-101,786	-32.5
Total Interest Expense on Deposits	1,021,528	1,529,402	-507,874	-33.2
FHLB Advances	584,214	582,202	2,012	0.3
Interest on other borrowings	4,890	15,518	-10,628	-68.5
Total Interest Expense	1,610,632	2,127,122	-516,490	-24.3
Net Interest Income	7,966,337	7,246,742	719,596	9.9
Provision for loan losses	2,379,000	1,349,000	1,030,000	76.4
Net In. Inc. After Prov. for Loan Losses	5,587,337	5,897,742	-310,404	-5.3
Non Interest Income				
Service charges and fees	74,323	67,819	6,504	9.6
Securities gains (losses), net	120,594	0	120,594	0
Mortgage loan and related fees	14,702	20,843	-6,141	-29.5
Other noninterest income	118,966	232,484	-113,518	-48.8
Total Non Interest Income	328,585	321,146	7,439	2.3
Non Interest Expense				
Salaries and employee benefits	3,211,940	2,248,455	963,485	42.9
Occupancy	396,179	408,350	-12,171	-3
Other noninterest expense	1,427,829	1,765,211	-337,383	-19.1
Total Non Interest Expense	5,035,947	4,422,016	613,931	13.9
Income Before Taxes	879,975	1,796,872	-916,897	-51
Income taxes	204,000	563,795	-359,795	-63.8
Net Income	675,975	1,233,077	-557,102	-45.2